

Messrs Harvey Goldschmid and Hans Hoogervorst, Co-Chairmen
Financial Crisis Advisory Group
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116
United States of America

02 April 2009

Dear Mr Goldschmid and Hans Hoogervorst,

Re: Financial Crisis Advisory Group Invitation to Comment – 10 March 2009

Deloitte LLP, the UK Member Firm of Deloitte Touche Tohmatsu, is pleased to provide comments (additional to those provided by Deloitte Touche Tohmatsu) in response to the Financial Crisis Advisory Group's Invitation to Comment of 10 March 2009. This letter addresses a particular financial crisis-relating issue that is of particular interest in the UK.

Highlighting matters related to going concern

Going concern is one of the two underlying assumptions in the IASB's Framework for the preparation and presentation of financial statements. However, in the body of IFRS, discussion is effectively limited to two paragraphs—paragraphs 25 and 26—in IAS 1 (2007). These paragraphs provide that: (i) IFRS financial statements are to be prepared on a going concern basis; and (ii) when management assesses that this basis is no longer appropriate, it must make certain disclosures. In particular, when management is aware “of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties”.

Therefore, under IFRS, an entity would always prepare financial statements on the going concern basis, and would disclose matters pertinent to its continuation as a going concern only in extreme cases, i.e. when the audit report will contain an emphasis of matter or when the going concern basis is inappropriate. Even when the auditor determines that an emphasis of matter in the audit report is necessary (i.e. significant doubt/ material uncertainty), there is little guidance on the nature, extent and location of the disclosures required by IAS 1 and no requirement to use the words ‘going concern’.

We acknowledge that there are likely to be other disclosures that are of interest to the question of going concern. These include disclosures driven by, amongst others, IFRS 7, other parts of IAS 1 and so on. However, such disclosure may be scattered throughout the financial statements rendering them less useful to users than they would be when presented cogently.

The current economic conditions have highlighted:

- An urgent need to co-ordinate and streamline the disclosures relevant to the assessment of going concern. This highlights a problem inherent in IFRS at present in that there is no requirement to have a discussion of business risks in the financial statements. IAS 1's notes on significant accounting policies and sources of estimation uncertainty may give some clues to these but would not necessarily include generally a description of the business model and the risks and uncertainties therein. In the European Union, such matters are required to be disclosed in the directors' report accompanying the financial statements. The IASB might consider the disclosures in the FASB's proposed Statement on going concern discussed above.
- In IFRS and US GAAP, there is no requirement to disclose the particular factors which the directors or management have considered in reaching a conclusion on going concern. In particular, while directors or management may have based their going concern assessment on reasonable assumptions, we live in a time when the unexpected happens increasingly often. Accordingly, it may be important that these assumptions are disclosed. Somewhat curiously, IFRS demands disclosure of sensitivities around impairment assumptions on particular assets but does not require such disclosure on going concern, one of the two fundamental linchpins of financial reporting.
- There should be a clear conclusion from the directors or management on their assessment of the going concern assumption. At the moment IFRS and US GAAP require a statement only in relatively few situations.

We attach our submission dated 27 February 2009 to the UK's Financial Reporting Council on this and related matters.

If you have any questions concerning our comments, please contact Ken Wild at +44 (0) 207 007 0907 or Veronica Poole +44 (0) 207 007 0884.

Sincerely,

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ken Wild', written over a horizontal line.

Ken Wild
National Director of Assurance and Advisory Services

Appendix

Submission to the UK Financial Reporting Council, 27 February 2009

For the attention of Steven Leonard
Financial Reporting Council
5th Floor
Aldwych House
71-91 Aldwych
London
WC2B 4HN

By post and by email

27 February 2009

Dear Sir

Revision of the guidance for directors of listed companies on going concern

We write in response to the invitation to comment on the:

1. Consultation Paper issued by the Financial Reporting Council (FRC) in September 2008 on the proposals to revise the 1994 Guidance “Going concern and financial reporting: guidance for directors of listed companies registered in the UK”; and
2. practical challenges arising from applying the 1994 Guidance and the FRC’s “Update for directors of listed companies: going concern and liquidity risk” issued in November 2008.

We welcome the FRC’s decision to review the 1994 Guidance. This is timely given the developments in accounting standards since 1994 and the current economic climate. The November 2008 FRC Update is proving both challenging and constructive. We believe that the Update has been greatly welcomed by directors and is proving of considerable assistance in ensuring appropriate disclosure of the factors which the directors have considered in reaching their conclusion on the use of the going concern assumption. It also provides generally clear guidance on drawing together the various related disclosures on going concern and liquidity risk. The challenges arise principally from its non-mandatory status and the lack of clarity over its applicability to non-listed companies; the location of the disclosures; references in other corporate reports such as half-yearly financial reports and preliminary announcements; and other points, all of which we explain further in Section 2 of this letter.

In Section 1 below, we focus on issues raised in reviewing the Consultation Paper.

1. The revised 1994 Guidance

1.1 Need for guidance

Your question 1 asks if there is a continuing need for separate guidance for directors of listed companies on going concern. In the short term, we strongly believe there is such a need. Our preference is that in due course all the necessary reporting guidance on going concern is contained in accounting standards. We recommend that the FRC and its relevant operating bodies adopt this as a goal. Going concern is one of the two underlying assumptions in the IASB's Framework for the preparation and presentation of financial statements. Thus logic dictates that the relevant information on this assumption is given in the financial statements. Having all the guidance in accounting standards would have the benefit of providing that all those who adopt full IFRS (and UK GAAP assuming it is amended to follow IFRS) apply the same standards. The main difficulty with the current position in the UK is that the 1994 Guidance is written for directors of listed companies. While paragraph 8 of the 1994 Guidance notes that the guidance may be of assistance to directors of other entities, its status is clearly non-mandatory and those directors are justified in believing that the guidance is not designed for them.

We therefore recommend the FRC provides detailed proposals, including draft amendments, to the IASB on how IAS1 might be augmented to ensure that preparers discuss more fully the factors considered in, and the conclusion reached on, going concern.

We acknowledge that amending an international accounting standard and then its UK equivalent is unlikely to be achieved in the short term. Therefore the 1994 Guidance needs to be updated as appropriate and to reflect the guidance in the FRC's November 2008 Update.

1.2 The foreseeable future

IAS1 states that the foreseeable future is at least 12 months from the end of the reporting period. The FRC proposes to retain the period of 12 months from the date of the approval of the financial statements. We acknowledge that now may not seem to be the time to be proposing a reduction in the period, but wish to set out a number of points for further consideration.

- This piece of UK gold plating creates practical problems in international groups with UK parents. The overseas businesses are largely preparing their financial statements using IAS1 and the local auditors are using ISA570, the related Auditing Standard. The UK rule requiring a longer period means that special instructions have to be created, applied and reviewed. This adds to the cost of preparing the annual report.
- Typically subsidiaries' annual reports are not signed simultaneously with the parent company's group financial statements. With groups under pressure to issue their results as quickly as reasonable and to meet all the disclosure

burdens placed on them, it is inevitable that subsidiary financial statements are delayed for a period. But the UK's definition of foreseeable future being from the date of signing means that groups have to update formally their going concern work for subsidiary accounts. Again, this adds to the cost burden on UK groups.

- We are aware that UK private companies financial statements are not required to be filed until, from this year, nine months after the year end. Thus the argument is that only three months or so is being considered. We would stress that the requirement is to consider the foreseeable future. Our next comment is relevant to this.
- The UK's focus on twelve months from the signing date, being somewhat special and out-of-line internationally, means that attention may be focussed on that period to the detriment of considering the period thereafter. The requirement is to consider all available information about the future which is at least, but not limited to, twelve months from the chosen date.
- Companies typically prepare detailed budgets for the next year and forecasts thereafter for say three to five years' periods. There is potentially an artifice in the current UK requirement if the view is the UK has a higher standard.

1.3 Going concern basis not appropriate

The fourth conclusion listed in paragraph 47 of the proposed Guidance is for companies that are unlikely to continue in operational existence for the foreseeable future and therefore the going concern basis is not appropriate. However, IAS1 paragraph 27 requires the use of the going concern basis "unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so". In certain circumstances a company could be unlikely to continue trading, but management would not intend to liquidate the entity or cease trading and would not be in a situation where they had no realistic alternative but to do so. We believe that the wording should be aligned.

1.4 The basic conclusions

The addition of a fourth option (paragraph 47 of the proposed Guidance) that directors can reach regarding the appropriateness of the going concern basis results in there being two out of four options referring to doubt on the ability of the company to continue as a going concern. We are aware that the corporate community has significant concerns about this as an outcome as it introduces another unnecessary layer of complexity. In our view, the problematic option is the second option referring to doubts. The November 2008 Update reinforces our views that there are three options:

- a. a reasonable expectation that the company will continue in operational existence for the foreseeable future:

- b. material uncertainties casting significant doubt about the ability of the company to continue in operational existence for the foreseeable future; and
- c. the going concern basis is not appropriate.

We recommend that the proposed Update is revised to reflect the above.

1.5 Position of the statement

In the proposed Guidance, references to the Operating and Financial Review (OFR) have been replaced with references to the Business Review, with no attempt to reword the surrounding narrative. It presumes that a Business Review is synonymous with an OFR and suggests the statutory Business Review would be incomplete without a going concern statement. The latest Deloitte survey of narrative reporting, 'Write from the start', shows that 48% of companies surveyed included the going concern statement within the corporate governance statement. 9% included the statement within the OFR and the remainder included it within the directors' report.

Given the survey results noted above, we believe it would be more appropriate for the guidance to offer alternative locations for the statement. The new Disclosure and Transparency Rule (DTR) 7.2 requires the production of a Corporate Governance Statement and, since the going concern statement emanates from the Combined Code, this is a logical alternative position and is currently accepted practice.

We believe a more logical place for the going concern statement would be in the financial statements. It is here that the assumption is used in preparing the financial statements. When the statement was introduced in 1994 it was developed as part of the then new corporate governance statements and its current recommended position owes probably more to accidents of history than a considered view.

While history and the UKLA's DTR have resulted in the statement appearing in the narrative in listed companies, the current desire to ensure that all preparers focus appropriately on the going concern assumption and disclose relevant factors regarding its adoption, has illustrated the patchwork of rules and recommendations in this area. As the going concern assumption is fundamental to financial reporting, the financial statements should contain the preparers' comments on its adoption. Hitherto the UK accounting standard setters have presumably been influenced by the UKLA's rules on listed companies. The FRC's Study on going concern and liquidity risk disclosures has highlighted that the current disclosures are scattered throughout the financial statements and accompanying narrative. The FRC November 2008 Update's statements neatly pull together the relevant disclosures, disclose the key factors and then provide the directors' conclusion.

In the current economic environment it is difficult to argue that such statements are not a key part of financial statements and should now be part of considering

whether the financial statements give a true and fair view. We discuss the consequences of this conclusion in 1.1 above. As noted there, we acknowledge that changing accounting standards may not be achieved quickly. In the interim, we therefore recommend that the revised Guidance requires that the going concern statement, wherever located in the narrative section, is referred to, at least in part, from the financial statements and thus forms part of these.

1.6 Need to refer to judgement being at a specific time

The suggested disclosure that the going concern basis is appropriate in paragraph 49 makes no reference to the important fact that the directors' judgement is made at a particular time. We include the following specimen wording in the Deloitte guidance materials and would commend this clarification:

*"After making enquiries, the directors have formed a judgement, **at the time of approving the financial statements**, that there is a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason, the directors continue to adopt the going concern basis in preparing the financial statements."*

1.7 Impairment reviews

IAS 36 'Impairment of assets' is mentioned in paragraph 29A and again in the Appendix. While the subject of impairment reviews is relevant, we believe any such reference should be restricted to the list of other factors to consider in section 7.1 of the Appendix. Impairment reviews are required only in very specific cases and consider both net realisable value and value in use. Where forecasts are examined to determine value in use, only those cash flows directly associated with a particular asset, or group of assets, are considered over a period. Company-wide forecasts are not necessarily assessed for this purpose and we believe any such implication in the Guidance would be misleading.

1.8 Interim reporting

We note that the paper contains an updated paragraph 57 on interim reporting and that it now refers to half yearly financial reports and interim management statements (IMS). However, the section goes on to provide guidance on reviews "at the interim" only. While we assume that this refers to the half-yearly report, we recommend that this should be clarified. There is no further guidance on how to deal with going concern within the IMS. We recommend the following.

- The final two sentences of paragraph 57 should be rewritten to avoid the impression that at the half-yearly point directors are required merely to review their previous work and thus the foreseeable future is limited to a period of approximately six months. IAS34 requires, by reference to IAS1, that the period is twelve months from the half-yearly reporting date. The position for UK GAAP reporters is less clear. The FRC should clarify what it considers to be the minimum period to be reviewed and in particular

whether it is following IAS34 or taking twelve months from the signing date (please see our comments at 1.2 above).

- The Guidance should clarify what directors might be required to disclose about going concern in their half-yearly reports. We do not believe that a formal statement from the directors is required. But the FRC should discuss the relevant disclosures and include some example comments to illustrate what might be needed in particular situations.
- The IMS requires a general description of the financial position of the entity. We know from a recent Deloitte survey of IMS 'First IMpressionS' that this requirement is handled poorly in practice. We suggest that the FRC discusses with the FSA what might be reasonably expected in an IMS's description of financial performance regarding going concern, with the aim of providing some examples in the revised Guidance.

We have made the similar comment, requesting examples, immediately above on half-yearly financial reports. Both are based on our experience of how the illustrative wordings in the Update have greatly assisted preparers and auditors in providing appropriate disclosures.

1.9 Illustrations

Echoing our comments at 1.8 above, we believe it would be beneficial to have a series of illustrated going concern statements under a range of common scenarios. Such illustrations are invaluable guidance for entities applying the rules.

1.10 References to UK GAAP

We note that the Guidance has been updated to refer only to IFRSs. But many listed companies (such as investment trusts) continue to report under UK GAAP and will use this guidance. We suggest that the equivalent UK GAAP requirements are detailed in the revised Guidance.

2. The November 2008 FRC Update

2.1 Non-mandatory status and its applicability to non-listed companies

We congratulate the FRC in issuing so promptly the November Update. It is proving its worth during the current reporting season and, in many cases, improving the disclosures on going concern in annual reports. Furthermore, our experience from discussing the "requirements" with directors generally is that they have welcomed the Update, acknowledging that it represents good sense in the current economic conditions.

That said, challenges arise from its non-mandatory status and in particular over its applicability to non-listed companies. We have discussed at 1.1 and 1.3 above various aspects of this challenge. We have also noted how amending

accounting standards would be an ideal solution, in our opinion. An alternative idea might be to extend, by secondary legislation, the disclosures applicable to all companies in the UK so that directors are required to include a statement on going concern in their annual reports. A relatively short requirement in company law could then be backed up by guidance from the FRC. We have some hesitation in suggesting this route as it may be the proverbial sledge hammer to crack the nut approach. However, before concluding on whether this approach should be explored, we recommend the FRC considers the extent to which companies are currently adopting as best practice the guidance in the Update.

2.2 The location of the disclosures

We discuss this issue at 1.5 above.

2.3 References in other corporate reports

We discuss at 1.9 above the subject of interim reporting both at the half year and in interim management statements. Further particular challenges have been the extent to which commentary is required in preliminary announcements and in summary financial statements (SFS). The UKLA helpfully included some comments on preliminaries in its List! magazine issued in January 2009. We recommend that the Guidance includes a statement that directors should consider including their going concern statements in preliminary announcements and in particular should ensure that those statements, if they are to be published later, are not expected to include any new information to the market. We also recommend that the Guidance covers the SFS. Our current view is that, given the abbreviated nature of the SFS, the going concern statement should not be reproduced therein and that reference to going concern should be required only in cases of material uncertainty or non-use of the going concern basis. The Guidance may want also to say that this is a matter of judgment for directors and that they may wish to give a reference in SFS to where the going concern statement is in the annual report.

Isobel Sharp and Martyn Jones would be pleased to meet with you to discuss in more detail our comments.

Yours faithfully

Deloitte LLP